In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 603

MILWAUKEE & SUBURBAN TRANSPORT CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The issue involved in this case is whether the taxpayer, a self-insured municipal transit company filing its federal income tax returns on the calendar year and accrual basis, may deduct from its gross income for the taxable years a reserve set up on its books to reflect an estimated amount of aggregate liabilities for contested and unsettled claims for personal injuries and property damages arising out of accidents occurring in the taxable years.[1]

[1] The issue involved is sometimes referred to as the accounting method issue, in order to distinguish it from a second issue in the case, relating to preferred stock, as to which the Tax Court was affirmed by the court of appeals, and a petition for a writ of certiorari by the taxpayer was denied by this Court. *Milwaukee & Suburban Transport Corp.* v. *Commissioner*, 366 U.S. 965.

1. This is the second time this question has been presented to the Court by petition for a writ of certiorari. The prior petition was filed in No. 843, October Term, 1960, on behalf of the Commissioner. Originally, the Tax Court sustained the Commissioner's disallowance of the deduction, holding that the estimated amounts reflected in the reserve account were not accruable and deductible in the respective taxable years in which they were claimed as deductions, since the taxpayer's liability to pay had not become definite, but, on the contrary, was being contested. 1959 P-H T.C. Memorandum Decisions, par. 59-216; Petition in No. 843, *supra,* pp. 10-41. On October 24, 1960, the Court of Appeals for the Seventh Circuit reversed on the ground that, although the taxpayer's liability for each individual claim was being contested and remained contingent, the "aggregate" amount of "over-all" liability could be accurately predicted. 283 F. 2d 279; Pet. 23-40, 41. The Commissioner filed a petition for a writ of certiorari to review this decision, suggesting that action on the petition be suspended pending the disposition of *American Automobile Association* v. *United States,* No. 288, October Term, 1960 (eventually decided at 367 U.S. 687), and *United States* v. *Consolidated Edison Co. of New York,* No. 357, October Term, 1960 (eventually decided at 366 U.S. 380). On June 19, 1961, this Court entered the following order disposing of the Commissioner's petition (Pet. 42-43; 367 U.S. 906):

> It is ordered and adjudged by this Court that the judgment of the said United States Court of Appeals, in this cause, be, and the

same is hereby vacated; and that this cause be, and the same is hereby, remanded to the United States Court of Appeals for the Seventh Circuit in the light of *American Automobile Association* v. *United States*, No. 288, October Term, 1960, decided this day, and *United States* v. *Consolidated Edison Company of New York, Inc.*, No. 357, October Term, 1960, decided May 22, 1961.

* * * * *

Mr. Justice Douglas dissents.

On August 3, 1961, upon application of the taxpayer, the court of appeals granted leave to the parties to file briefs "on the question of the action to be taken by this court on the remand from the Supreme Court." The taxpayer thereupon submitted a motion to reinstate the judgment accompanied by a supporting memorandum in which it argued, for reasons set forth in its petition here, that it was entitled to the claimed deduction in the light of the *American Automobile Association* and *Consolidated Edison* cases. The Commissioner filed an opposing memorandum, to which the taxpayer replied. On September 12, 1961, the court of appeals, by a memorandum opinion and order held that "in the light of the consideration of the cases above cited [*i.e.*, the *American Automobile Association* and *Consolidated Edison* cases]," its mandate to the Tax Court should be recalled, its earlier judgment of October 24, 1960, vacated, and the decision of the Tax Court with reference to the accounting method issue affirmed. 293 F. 2d 628; Pet. 44–45. On October 4, 1961, the taxpayer's petition for rehearing was denied.

2. It is thus apparent that the first ground relied upon by the taxpayer—that the court of appeals did not reconsider the issue in this case in the light of the *American Automobile Association* and *Consolidated Edison* cases—is without substance. That the court below did not issue a full opinion upon such consideration is no ground for certiorari, particularly since its decision is explicable as representing the view of the court below that the opinions of this Court in the two cited cases were sufficient to dispose of the tax accounting problem involved in the case at bar.

We think that this conclusion of the court below is correct. The taxpayer's claim to an accrual for a reserve for an aggregate liability determined through a pooling of individually contingent and contested claims is directly in conflict with the holding of the *American Automobile Association* case, *supra,* that "statistical computations" of the aggregate estimated cost "on a group or pool basis are without determinant significance" since "the federal revenue cannot * * * be made to depend upon average experience in rendering performance and turning a profit." 367 U.S. at 693. Here, as in that case, individual contingent liabilities may not be treated as fixed and accrued for federal tax purposes merely because the claims which give rise to them are numerous, and the aggregate amount which would become fixed may, by proof of past "overall experience," be reasonably predicted. Distinguishing the cases upon which the taxpayer here also relies, the *American Automobile Association* opinion stresses that, in order to be deductible within the taxable year, a liability must be a

"fixed individual expense" in that year, and that, while the taxpayer's system "doubtless presents a rather accurate image of the total financial structure," it "fails to respect the criteria of annual tax accounting." 367 U.S. at 692.

The second ground of decision in the *American Automobile Association* case—the legislative history of repealed Sections 452 (deferral of prepaid income) and 462 (reserves for future expenses) of the 1954 Code—is also squarely applicable here. Section 462 when enacted carried with it a new authorization to taxpayers for the deduction of reserves for "certain liabilities for self-insured injuries and damage claims" (H. Rep. No. 1337, 83d Cong., 2d Sess., A163; S. Rep. No. 1622, 83d Cong., 2d Sess., 63, 305–307) that was withdrawn by the repeal (69 Stat. 134) over the protests of witnesses for the transportation industry (see Hearings before the House Ways and Means Committee on H.R. 4725, *Prepaid Income and Reserves for Estimated Expenses*, 84th Cong., 1st Sess., 153–54, 156, 188–89; Hearings before the Senate Finance Committee on H.R. 4725, *Prepaid Income and Reserve for Estimated Expenses*, 84th Cong., 1st Sess., 67).

It is clear from the foregoing that the *American Automobile Association* case cannot be distinguished from the case at bar, as the taxpayer seeks to do (Pet. 20), on the ground that it involved prepaid income rather than future expenses. From the viewpoint of annual tax accounting requirements, deferments of prepaid income and deductions of future expenses are but counterparts of one another.

Additional and conclusive support for the correctness of the decision below is furnished by the *Consolidated Edison* decision, which held that a contested liability was not accruable for tax purposes even though during the contest the liability was paid under protest. Since the liabilities in question here admittedly remained both contested *and* unpaid during the taxable year in which they were claimed as deductions, it follows *a fortiori* that they had not yet ripened into deductible expenses for that year.

3. In any event, as its action on the prior petition for certiorari in this very case indicates, this Court has given full consideration to the principles governing accrual tax accounting in the *American Automobile Association* and *Consolidated Edison* decisions, leaving to the courts of appeals the application of the restated principles to then pending and future cases. A fresh review by this Court at this time is unnecessary, and the petition for a writ of certiorari should be denied.

Respectfully submitted.

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